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In the
# Supreme Court of the United States

OCTOBER TERM, 1966

No. 872

J. FLEET COWDEN ET AL.,
PETITIONERS,

*v.*

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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COMMISSIONER OF INTERNAL REVENUE,
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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

The petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the First Circuit entered in the above case on September 21, 1966.

### Opinions Below

The opinion of the Tax Court of the United States [R. 81] is reported at T. C. Memo 1965-278, 24 CCH Tax Ct. Memo 1528 (1965).

The opinion of the Court of Appeals for the First Circuit [R. 103] is reported at 365 F.2d 832, and is reprinted as Appendix A to this Petition.

## Jurisdiction

The judgment of the Court of Appeals for the First Circuit was made and entered on September 21, 1966 [R. 104] and a copy of the opinion of that Court is set forth in Appendix A hereto appended at page 14. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

## Questions Presented

1. Whether a trust (the income of which is taxable to the petitioners), which, in implementation of a long-held and consistent plan and purpose to exchange ten out of eleven unimproved lots of land held by it for investment for a completed improvement, namely, a building, itself real property, on the single retained lot, sold ten lots and subsequently constructed a building on the retained lot, using the entire proceeds from the sale in part payment for such construction, was entitled to treat said transactions as steps of a composite transaction constituting a nontaxable exchange within the contemplation of § 1031 of the Internal Revenue Code of 1954, or whether the transaction of sale must be singled out of the series of transactions giving rise to a taxable gain.

2. Whether amounts expended by the petitioner as an attorney acting as counsel for the trust, in connection with the acquisition of the trust property and with litigation to clear title thereto, and being in the same categories of expenditures and disbursements allowed the petitioner with respect to all his clients other than the trust, were properly disallowed and treated as constituting additional

cost of the trust property, solely because the petitioner was trustee of the trust.

3. Whether the petitioners are liable for an addition to tax under § 6651 of the Internal Revenue Code of 1954 for failure to file an income tax return for the taxable year 1959 on the date designated therefor, or whether said failure was due to reasonable cause and not wilful neglect.

4. Whether the petitioners sustained a loss for the taxable year 1959 entitling them to a refund of taxes paid by them for the taxable years 1956 and 1957 under the loss carry-back provisions of the Internal Revenue Code of 1954.

## Statutes, Federal Rules, and Regulations Involved

The pertinent portions of the statutes, federal rules and regulations involved, namely, the Internal Revenue Code of 1954, §§ 1031(a) and 6651(a), Rev. Rul. 57-469, C.B. 1957-2, p. 521, and Treasury Regulation § 1.1031(a)-1, (b) are set forth in Appendix B appended hereto at pp. 15, 16.

## Statement

Petitioners are husband and wife and resided in Massachusetts throughout the year 1959 [R. 19], the petitioner J. Fleet Cowden being an attorney at law admitted to practice before the courts of Massachusetts and various courts of the United States, and actively engaged in the practice of law at Sudbury, Massachusetts [R. 20].

The petitioner J. Fleet Cowden is also the settlor-trustee of the Deirdron Trust set up in 1953 on the occasion of the acquisition by the trust of 13.8 acres of unimproved real property [R. 20]. Under the provisions of the In-

ternal Revenue Code of 1954, particularly the provisions of Subpart E of Subchapter J of Chapter 1, the income of the trust during the taxable year 1959 is attributable to the petitioner Cowden as grantor or settlor [R. 21].

In or about 1954 unrelated third parties commenced proceedings to re-zone an area including the realty owned by the Deirdron Trust; whereupon Cowden, as trustee, and acting as attorney for the trust, subdivided the trust real estate into eleven lots [R. 21].

In or about 1953 there existed a cloud on the title to the trust realty. In 1954 the Deirdron Trust commenced litigation to remove this cloud. Said litigation and other litigation took five and one-half years to complete, and it was successfully concluded in May, 1959 [R. 21].

Architect's plan for a unique multi-purpose structure to be erected on one of the eleven lots were formulated and completed in 1954 [R. 25], and the intention to construct the same remained at all times thereafter a consistently held purpose of the trust and of the trustee [R. 23, 24, 25].

The trust had no assets other than the realty prior to 1959 [R. 31], and from and after 1954, the only method of financing the construction of the proposed building contemplated was the exchange of the unneeded ten lots for the building, completed in accordance with the architect's plans, actually erected on the single lot retained [R. 31, 32]. Extensive attempts were made to negotiate the "intended exchange", namely, the ten unimproved lots for one completed improvement (the building) [R. 33, 34, 35], and ultimately such an exchange agreement was entered into by the trustee with one Moulton, but later dishonored by the latter [R. 34, 51, 52], who, while refusing to proceed with the contract of exchange, claimed the legal right to purchase the ten lots, and threatened to tie up the trust property with liens and litigation for a further period of

time, unless this claimed right was recognized [R. 36]. A contest of Moulton's claim, regarded as invalid, would have involved further legal expense and the risk of an increase in construction costs during any period of further litigation, and such contest was abandoned by Cowden after consultation with other attorneys in favor of the only method left to him to carry out the original plan of the trust [R. 31]. That method was to dispose of the ten lots in 1959 to the reneging Moulton for $31,000.00 in cash, depositing the cash in a bank to the account of the trust [R. 21], and using said cash as far as it would go to construct the building, acting himself as general contractor. This he did. The building was substantially completed on July 31, 1960 [R. 39]. Even though Cowden acted as general contractor and did considerable construction work by hand himself, the cash proceeds of the sale of the ten lots, $31,000.00, reduced by the expenses of the previous years of litigation [R. 38], were inadequate to pay the actual construction costs incurred, and the deficit was met by the personal borrowing of the petitioner Cowden [R. 39].

At all times the trust property both before the construction and afterwards was held by the trust for the purposes of investment for the production of income and the realization of gain by appreciation upon ultimate disposition [R. 23]. Of necessity, however, for the purpose of acting as caretakers to prevent deterioration and damage, and to utilize spare time to complete the building, the petitioners moved into the structure in 1960 and occupied it as their residence. In 1961, the petitioner Cowden moved his law office into the building for the same reasons [R. 40].

In the year 1959, Cowden, as attorney, made certain disbursements directly related to the practice of law by him, in the nature of advances for clients, on behalf of the trust. The character of these expenses and disbursements was similar to the character of disbursements made by

him in the same year for other clients, as well as disbursements made in prior years [R. 29, 30, 31].

The nature and character of the expenses and disbursements on behalf of the trust incurred in the year 1959, and disallowed by respondent as deductions claimed as ordinary, necessary and reasonable expenses of conducting business as an attorney, were: (1) Payment of fees to other attorneys retained as consultants (separate from and additional to the fees of other attorneys paid directly by the trust); (2) Payment of fees to a surveyor for surveying the land in connection with some of the proceedings already described; (3) Payment of a $50.00 item of purchase price for land—similar to the token deposits commonly advanced by attorneys; and (4) The printing costs involved in the appeals in the litigation previously described [R. 31].

The total amount of these business expense deductions claimed by petitioner is $3,276.66. In disallowing these deductions, respondent acted upon the theory that they were barred because of the relationship between Cowden as grantor-trustee and the trust for whose benefit the advances or disbursements were made. At the trial, respondent also urged that they were not of the character allowable under Sec. 162 [R. 18]. It is undisputed that similar expenses or advances for clients other than the trust were allowed by respondent [R. 42]. The court noted that there was no objection to this testimony [R. 43].

If the respondent is correct that petitioners realized a long-term capital gain on the trust's disposition of realty in 1959, and that $3,276.66 was disallowable, then the deficiency is $1,384.19 for the tax year 1959, (aside from the deficiency penalty asserted in the sum of $346.05). On the other hand, if the disposition was a tax-free exchange under Sec. 1031 of the 1954 Code, and $3,276.66 was an allowable deduction, petitioners' tax return for 1959, show-

ing a loss of $7,004.88, is correct, and the petitioners are entitled to a refund of $569.30 for 1956 and $331.57 for 1957.

Petitioners' return for the year 1959 was filed late, and a penalty was assessed. The record is clear both that problems relating to the construction of the building prevented the availability of figures from which a return could be filed on time, although it was known that there would be a substantial loss, and that independent advice of tax counsel as to the propriety of treating the transfer of the land as part of an exchange had been obtained in advance [R. 44, 48, 49, 50, 51]. This evidence was offered for the purpose of showing reasonable cause for late filing, including the opinion of counsel.

Petitioner also testified that, after the filing of the return, he had two discussions with an Acting Associate Chief of the Appellate Division of respondent's Boston Regional Office, a Mr. Grandberg, concerning the imposition of this penalty [R. 44]. When further evidence as to these discussions was ruled out upon objection, petitioner made an offer or tender of evidence to the effect that this Mr. Grandberg expressly agreed with petitioner that it would be deemed established, and would be ruled, that reasonable cause had been shown, and the penalty would not be imposed, if petitioner would supply an affidavit from independent counsel establishing that the advice had been given in advance of the due date for filing the 1959 return, that the disposition of the land was not a taxable transaction; that petitioner, in reliance on this representation and agreement, obtained such an affidavit and submitted the same; that, nevertheless, the penalty was thereafter asserted [R. 46, 47].

This case was heard in the first instance by the Tax Court of the United States upon whom jurisdiction for the redetermination of a deficiency assessed by the Com-

missioner of Internal Revenue is conferred by the Internal Revenue Code of 1954, §§ 6213 and 6214. The decision of the Tax Court was reviewed by the Court of Appeals for the First Circuit upon whom jurisdiction to review a decision of the Tax Court of the United States is conferred by the Internal Revenue Code of 1954, § 7483.

## Reasons for Granting the Writ

The courts have repeatedly held that where a sale is part of a transaction the purpose of which is to effectuate an exchange, and whereby an exchange has resulted, the transaction is an exchange for tax purposes and the sale is to be disregarded. Mertens, Law of Taxation, vol. 2, § 20.28, Cum. Supp. This has been referred to as the "step transaction" rule, upholding which are many United States Court of Appeals decisions, Revenue Rulings and Regulations, and Congressional intent, principal among which may be cited the following:

*Century Electric Company* v. *Commissioner,* 192 F.2d 155, certiorari denied 342 U.S. 954; *Thurber* v. *Commissioner,* 84 F.2d 815; *Allegheny County Auto Mart, Inc.,* 12 T.C.M. 427, affirmed *per curiam,* 208 F.2d 603, 54-1 USTC, Par. 9138 (3 Cir. 1954); *Louis W. Gunby, Inc.* v. *Helvering,* 122 F.2d 203; *Badgett* v. *U. S.,* 175 F. Supp. 120 (1959); *Portland Oil Company* v. *Commissioner,* 109 F.2d 479; Rev. Ruling 57-469, C.B. 1957-2, p. 521; Rev. Ruling 60-43, 1960 I.R.B.-5, p. 39; Reg. 118, § 39.112 (a)-1; Int. Rev. Cum. Bull. 1939-1 (part 2), p. 564 (source: a House Ways & Means Committee Report quoted by the court in *Jordan Marsh* v. *Commissioner,* 269 F.2d 453 (CCA 2, 1959); *Alderson* v. *Commissioner of Internal Revenue,* 317 F.2d 790 (CCA 9, 1963).

The Court in the *Century Electric* case, 192 F.2d at 159, stated: "The answer to the question is not to be found

by a resort to the dictionary for the meaning of the words 'sales' and 'exchanges' in other contexts, but in the purpose and policy of the revenue act as expressed in Sec. 12 . . . Subsection 112(b) (1) and 112(e) indicate the controlling policy and purpose of the section, that is, the nonrecognition of gain or loss in transactions where neither is readily measured in terms of money, where in theory the taxpayer may have realized gain or loss but where in fact his economic situation is the same after as it was before the transaction. . . For tax purposes the question is whether the transaction falls within the category just defined. If it does, it is for tax purposes an exchange and not a sale."

The House Ways & Means Committee Report quoted by the Court in the *Jordan Marsh* case, *supra,* states: "But if the taxpayer's money is still tied up in the same kind of property as that in which it was originally invested, he is not allowed to compute and deduct his theoretical loss on the exchange, nor is he charged with a tax upon his theoretical profit. The calculation of the profit or loss is deferred until it is realized in cash, marketable securities or other property not of the same kind having a fair market value."

Further, the language from Reg. 118, § 39.112(a)-1, namely, "Underlying assumption of these exceptions is that new property is substantially a continuation of the old investment still unliquidated" is quoted with approval by the Court in *Commissioner* v. *P.G. Lake, Inc.*, 356 U. S. 260 (1958).

In the view of the petitioners, the decision of the Court of Appeals for the First Circuit in this case conflicts with numerous decisions of other Courts of Appeals, some of which are cited above, as well as with one of its own decisions *(Thurber* v. *Commissioner, supra)* on the same matter. However, it appears, as was conceded in argument on

appeal before the Court of Appeals by both the petitioner and the respondent, that no case "on all fours" with the present case has ever been found, leaving it open for the respondent to argue that the decision can in no way be regarded as conflicting with prior decisions. The petitioners contend that the analogy of the instant case with prior cases is too strong to be disregarded, so that a true and serious conflict exists which should be settled by this Court. Nevertheless, if the instant case be regarded as presenting a case of first impression, then the Court of Appeals for the First Circuit must be taken to have decided an important and *recurrent* question of federal law which has not been decided by this Court or any court, and which should be settled by this Court.

It is too easy to take a great step backward and say, just because no case "on all fours" with the instant case exists, that we can now disregard analogy and base decision in this case on the dictionary, in spite of all the learning provided by analogous cases. The petitioners contend that in this case the Court of Appeals has decided a federal question in a way in serious conflict with applicable decisions of this Court itself, and has also sanctioned such a serious departure from the accepted and usual course of judicial proceedings by the Tax Court of the United States as to call for an exercise of this Court's power of supervision.

The Deirdron Trust at all times intended to exchange unimproved for improved property, by giving up ten unimproved lots not needed, for one completed building to be erected on one lot retained for that purpose. It implemented and perfected this exchange by the only means available after the original exchange agreement, through no fault on its part, failed. There is no doubt that by giving up ten lots the trust acquired improved realty (the structure itself under Massachusetts law), which it an-

nexed to the land retained. So far as the trust is concerned it accomplished the intended exchange it had planned for years. The respondent in this case, recognizing the law on the subject, *conceded* at oral argument before the Court of Appeals that, *if the original agreement with Moulton had been carried out, a nontaxable exchange would have resulted!* The respondent's position, then, is that, because an alternative technique to accomplish the same thing was necessarily employed, as the only one open to the trust, requiring a series of transactions including a sale as one of the steps, a nontaxable exchange did not result. This cannot be the law. It is plainly an unwarranted emasculation of the Congressional intent of the law of nonrecognition of gain or loss, as interpreted by the decisions and regulations, accomplished through the semantics of a lexicographer. The substance of the transaction of which a sale is only a part, it is submitted, is the controlling factor. Where, as here, the purpose is to effectuate an exchange, and such an exchange is in fact accomplished by means of an "unrecognized" method, just as surely as it could have been accomplished by a "recognized" method, certainly the accident of circumstance forcing or dictating the use of the "unrecognized" method cannot, it is submitted, become a trap to enmesh the innocent taxpayer acting in good faith and with bona fide investment purposes in serious tax consequences. The inequity of such a rule is as obvious as its inconsistency with the cited authorities with which it is in direct conflict. The problem of forecasting tax consequences in the area of like-kind exchanges has for years been made difficult because of conflicting decisions upon the same or closely analogous facts. The problem—a recurrent one—which will surely involve other taxpayers forced to resort to "unrecognized" methods of effectuating a desired and perfectly legitimate exchange, should be alleviated by an

eclectic decision of this Court. Such an exercise of supervision by the Court would "clear the air" in this "gray area" of taxation. It would prevent a "hardening" of policy by the Internal Revenue Service based upon the decision in this case, a policy clearly retrograde, which cannot be countenanced in the light of the decided cases.

The above argument is directed to the first question presented for review, the question of a tax-free exchange, the importance of which question in the posture of this case is relied on primarily by the petitioners to invoke this Court's power of supervision. By virtue of the decision sought to be reviewed in this Court there has now been thrown into doubt—plucked up, if you will—the guideposts of the law of nonrecognition of gain or loss so carefully placed over the years by the lawmakers, the courts, and the Internal Revenue Service itself, and which for as many years have been relied upon by the taxpayers of this nation. Such uncertainty should not now be created for the taxpayers, it is submitted, except after the careful scrutiny and consideration of their highest tribunal.

The other questions presented for review likewise call for an exercise of this Court's power of supervision. The decision of the Tax Court as affirmed by the Court of Appeals as to the non-deductibility of the petitioner's law office advances and disbursements relied on and was based on clearly inapposite authorities. The decision on this question is highly confusing and has thrown into doubt the ordinary and common practice of attorneys at law regarding such deductions.

The decision as to the late filing penalty involves two defects. First, it is in complete conflict with *American Assn. of Engineers Employment, Inc.*, Memo TC, aff'd. 204 F.2d 19, '43, AFTR 894. Second, the decision permits the Government of the United States to break an agreement, relative to which the petitioner was allowed to make only

an offer or tender of evidence, contrary to the wisdom of this Court as appears in *Bull, Exr.* v. *United States,* 295 U. S. 247, 35-1 U.S.T.C. Par. 9346 (1935).

## Conclusion

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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Appendix A

# United States Court of Appeals
## For the First Circuit

No. 6714.

J. FLEET COWDEN ET AL.,
PETITIONERS,
*v.*
COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES
[24 CCH Tax Ct. Mem. 1528 (1965)]

Before ALDRICH, *Chief Judge*,
MCENTEE and COFFIN, *Circuit Judges*.

*J. Fleet Cowden* for petitioners.
*Donald W. Williamson, Jr.*, Attorney, Department of Justice, with whom *Mitchell Rogovin*, Assistant Attorney General, and *Meyer Rothwacks* and *Harry Baum*, Attorneys, Department of Justice, were on brief, for respondent.

OPINION OF THE COURT.
September 21, 1966.

PER CURIAM. The decision of the Tax Court, November 24, 1965, Docket No. 1213-63, is affirmed.

## Appendix B

Section 1031(a): "*Nonrecognition of Gain or Loss From Exchanges Solely in Kind.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held for productive use in trade or business or for investment."

Section 6651(a): "*Addition to the Tax.*—In case of failure to file any return required under authority of subchapter A of chapter 61 (other than part III thereof), of subchapter A of chapter 51 (relating to distilled spirits, wines, and beer) or of subchapter A of chapter 52 (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes), or of subchapter A of chapter 53 (relating to machine guns and certain other firearms), on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to wilful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate."

Rev. Rule 57-469, C.B. 1957-2, p. 521, states in part: "In determining the substance of a transaction, the situation as it existed in the beginning and at the end of a series of steps and the object sought to be accomplished should be considered. In the instant case, since the sale was only a necessary step in reaching the ultimate desired exchange,

the transaction was an exchange within the provisions of Sec. 1031 of that Code."

Treasury Regulation Sec. 1.1031(a)-1, (b), states in part: "The fact that any real estate involved is improved or unimproved is not material, for that fact relates only to the grade or quality of the property and not to its kind or class."